Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Kuehl Analyst: Anne Mazur Bill Number: SB 1014

Related Bills: See Prior Analysis Telephone: 845-5404 Amended Date: April 23, 2007

Attorney: Patrick Kusiak Sponsor: ____________

SUBJECT: Impose Additional Tax On Income That Exceeds $200,000, Self-Employment Income, & Nonwage Income/Health Care Coverage Tax/California Health Insurance System Funding Law

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ________________.

__X__ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

__X__ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced February 23, 2007.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ________________.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 23, 2007, STILL APPLIES.

__X__ OTHER – See comments below.

SUMMARY

This bill would do the following:

- Impose additional taxes on certain wage income and nonwage income to fund a universal health care plan.
- Impose an excise tax on employers based on wages paid.
- Impose specified duties on the Employment Development Department (EDD).

This analysis addresses only provisions in the bill that impact the Franchise Tax Board (FTB).

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	5/8/07
____ N	____ OUA	__X__ PENDING		

SUMMARY OF AMENDMENTS

The April 23, 2007, amendments made the following changes:

- Inserted previously unspecified tax rates for additional taxes that would be imposed by this bill on taxable income (TI) of a specified amount, an individual's wages, and on employers based on wages paid.
- Added the Department of Finance (DOF) as an agency that FTB would consult with for establishing rules relating to the transfer of funds generated by the new taxes.

These amendments impact the This Bill, Economic Impact, and Arguments/Policy Concerns sections of the department's analysis of this bill as introduced February 23, 2007. These sections have been revised accordingly and are included below. The department's estimated costs to implement and administer the provisions of this bill are included in Fiscal Impact. Implementation Considerations and Technical Considerations are repeated below for convenience.

ANALYSIS

THIS BILL

For taxable years beginning on and after January 1, 2008, this bill would impose an additional tax at a rate of 1% on the portion of an individual taxpayer's TI that exceeds $200,000 but is not over $1 million. This additional tax could not be reduced by credits.

For taxable years beginning on and after January 1, 2008, this bill also would impose the following additional taxes:

- On the self-employment income of every individual taxpayer at an unspecified rate.
- On the nonwage income of every individual taxpayer at an unspecified rate.
- On the wages received by every individual taxpayer at a rate of 3.78%.

This bill would define "self-employment income" to mean the net earnings from self-employment, as defined by the Internal Revenue Code (IRC), made by an individual, excluding any amount less than $7,000 or more than $200,000.

This bill would define "nonwage income" as the amount of adjusted gross income (AGI) minus net earnings from self-employment, minus the amount of any wages, received by an individual. Nonwage income would exclude any amount in excess of $200,000. The term "wages" would be defined by a specified article of the Unemployment Insurance Code (UIC), but would exclude any amount less than $7,000 or more than $200,000. The tax on wages would be subject to withholding by the EDD with the amount determined using a method prescribed by the FTB. This bill would provide that the additional taxes on TI, self-employment income, and nonwage income would be subject to the estimated tax payment requirements, and also the interest, penalty, and other tax administration rules, as prescribed with respect to taxes imposed under Revenue and Taxation Code section 17041.

This bill also would impose an “excise” tax on employers at a rate of 8.17% on the wages paid to employees. For this purpose, the term “wages” would exclude any amount over $200,000 paid to each employee. This tax and the tax on employee wages would be administered by the EDD; however, both FTB and EDD would be required to jointly establish rules and regulations to implement these provisions of the bill.

This bill would specify that the proceeds of the additional tax are to be deposited in the Health Insurance Fund and shall be continuously appropriated to the California Health Insurance Agency for specified purposes.

This bill would also require, by November 15, 2008, FTB, in consultation with the Legislative Analyst and the DOF, to establish by regulation a transfer rate and mechanism for the revenue generated as a result of the additional tax rates. The bill specifies that the transfer rate and mechanism shall be based on those set forth in the provision that created an additional 1% tax on TI over $1 million enacted by Proposition 63.

This bill would require wage withholding by employers of the amount of taxes reasonably estimated to be due for the additional tax on wage income.

IMPLEMENTATION CONSIDERATIONS

The bill would require the department to draft regulations based on the Mental Health Services (MHS) tax to prescribe how certain provisions of this bill would be implemented. Based on that requirement, the department anticipates implementing this bill in the same manner, including the establishment of the transfer rate and funding mechanism, which would require changes to the computer systems, forms and instructions, and processing procedures.

The bill would require FTB to draft regulations to implement various provisions of the bill. Because of the lengthy process of developing regulations, such regulations likely would not be in place by the January 1, 2008, operative date of the bill. In the alternative, staff suggests that the mandatory regulation language be changed to a permissive grant of rulemaking authority to allow FTB to issue regulations as necessary. It is likely that some provisions of this bill could be implemented without going through the regulation process.

The bill would add new Part 10.1 to the Revenue and Taxation Code for the California Health Insurance Premium. Provisions under this part would add a new tax on wages for both employees and employers to be administered and enforced by EDD. To avoid confusion for employers, employees, and administrators, staff suggests that this part might be more appropriately placed in the UIC, where many of the definitions and rules that would be applicable to this part currently reside.

The department encountered issues in implementing the MHS tax involving how to apply the tax to nonresidents or in unusual filing situations such as partnership group returns, trusts, and other provisions that require withholding of tax computed at the "top marginal rate." Similar issues would need to be resolved in order to implement this bill.

The bill would define "nonwage income" with reference to AGI, as defined in IRC Section 62. The language of the bill is silent with respect to adjustments to federal AGI pursuant to California law. If it is the author's intent to reference federal AGI as adjusted for California purposes, it is suggested that the bill be clarified to achieve this result.

Under existing law, individual taxpayers with TI under specified thresholds are not required to file tax returns. It is suggested that the bill be clarified to indicate whether the filing thresholds would continue to apply if a taxpayer was subject to one or more of the taxes that would be imposed by this bill. If not, the volume of tax returns filed would increase substantially as would the burden imposed on the impacted taxpayers.

TECHNICAL CONSIDERATIONS

On page 6, line 16, strikeout "article." and insert "chapter." in lieu thereof.

This bill would require the revenues collected as a result of the additional taxes to be deposited into the Health Insurance Fund for purposes of administering health care benefits under the California Health Insurance System. Because the fund and the health insurance system would be created under another bill, SB 840 (Kuehl, et al.), should this bill be enacted without the passage of SB 840 the department would be unable to deposit the revenues into the appropriate fund. The author may wish to amend both bills to include contingent enactment language or combine both bills into one.

Staff also notes that the names used in this bill and SB 840 for the health care system and the fund do not agree. Specifically, SB 840 uses the names "California Universal Healthcare System" and "Universal Healthcare Fund." This bill uses the names "California Health Insurance System" and "Health Insurance Fund."

FISCAL IMPACT

The department's first year implementation costs to make changes to the computer systems, forms, instructions, and processing procedures for the additional taxes would be approximately $515,000. Annual costs to administer the additional taxes would be approximately $3.7 million. Such annual costs would be attributable to new workloads involving data capture, manual processing, phone center, and data storage. An appropriation would be required to fund these costs.

The department's costs to administer this bill would increase significantly if additional lines on certain tax returns to capture the new tax data would necessitate another page for those returns. An additional line and page would require new system programming, forms design, and printing, data capture, and storage costs.

ECONOMIC IMPACT

Revenue Estimate

The revenue impact of this bill, under the assumptions discussed below, is estimated to be as follows:

Revenue Impact of SB 1014 Effective For Taxable Years Beginning On Or After January 1, 2008 Enactment Assumed After June 30, 2007 ($ in Billions)			
	2007/08	2008/09	2009/10
Revenue Impact	+ $0.550	+ $1.450	+ $1.650

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

Using the department's micro-simulation personal income tax model, it was estimated that imposing an additional personal income tax at the rate of 1% on the taxpayer's taxable income that exceeds $200,000, but is not over $1 million, would raise the taxable year 2008 income-tax revenue by $1.5 billion.

The numbers in the table above have been adjusted to reflect revenue estimates for fiscal years.

ARGUMENTS/POLICY CONCERNS

Funding based on additional taxes imposed on high-income taxpayers creates uncertainty because the amount of income reported by high-income taxpayers is volatile.

A provision in this bill would impose an additional tax rate on taxable income that is between $200,000 and $1 million. This threshold is the same regardless of filing status. As such, this bill may provide an incentive for more married couples and registered domestic partners to determine whether it would be more beneficial to file separate rather than joint returns[1] in order to avoid this new tax on TI. Filing separately would allow such individuals to split their taxable income, the result of which may be under the specified threshold that would trigger the new tax.

[1] In general, individual taxpayers are required to use the same filing status for California purposes as they do for federal purposes. Married couples would therefore have to file separately for federal purposes if they wanted to do so for California. Effective for taxable years beginning in 2007, registered domestic partners are required to file jointly or separately by applying the standards applicable to married couples under federal income tax law, regardless of federal filing status. (SB 1827, Stats. 2006, Ch. 802.)

The additional taxes proposed in this bill would increase the complexity of complying with California income tax laws for many taxpayers. A substantial increase in complexity can have a negative impact on the voluntary nature of the tax system. More complexity also increases the rate of errors on tax returns.

LEGISLATIVE STAFF CONTACT

Anne Mazur
Franchise Tax Board
(916) 845-5404
anne.mazur@ftb.ca.gov

Brian Putler
Franchise Tax Board
(916) 845-6333
brian.putler@ftb.ca.gov